GOVERNMENT SECURITIES TRADE AT BUCHAREST SECURITIES EXCHANGE AND THEIR EVOLUTION IN THE CONTEXT OF “CENTENAR” TREASURY BILLS ISSUES

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Abstract

The problem of public debt took front stage after the international financial crisis, when it became obvious that countries with a high level of public debt will have problems in refinancing it. As there are many countries in the European Union (EU) that have a public debt higher than the 60% level and a few with over 100%, it may pose a problem for the future of the union. Romania, as one of the countries that has a low public debt level, uses the stock exchange to finance and refinance its public debt. We will investigate the role of the stock exchange and the trading evolution in the context of new Government decision to reinitiate the sale of treasury certificates directly to population with the issue of Centenar treasury bills.

Keywords: public debt, government securities, Bucharest Stock Exchange

JEL classification: H63, H74

Introduction

The importance of governmental bonds has been acknowledged many years ago, as they are considered the safest form of investment from the securities market. Blanco (2001) scales the market importance for governmental bonds, banks and private investors. The government bond market is characterized by low risk level, high market liquidity and high spread of maturities (Matei et al. 2008; Anghelache, 2009; Anghel, 2011, Vasile &Matei, 2010).

Romania government bond market had a slow start, influenced by a prolonged transition period and an underdeveloped stock market. The region came into the attention of the International Monetary Fund (IMF) in 2002 when in its Global Financial Stability Report presents the development of local emergent markets of bonds starting with 1997, but only for Czech Republic, Hungary and Poland. According to IMF, this increase was generated by the development of institutions mainly in the public debt management sector (IMF, 2002).Szilagy et al (2004) says that these countries promoted market segment development for complex governmental bonds and achieve liquidity by increasing the long-term maturity of government bonds. At the same time, in Romania, Russia and Ukraine, the government bonds issues have been limited and prevented the growth and liquidity of these markets (Iorgova & Ong, 2008).

Realising the importance of government bonds market for an economy and future developments of markets for debt instruments in Central and Eastern Europe (CEE), these states should encourage the central and local government to consider the bond issues as an alternative for their investment projects (Matei & al, 2009a; Pop et al, 2012; Bunescu, 2016)

The literature provides lot of studies that tackle the problem of government debt. A large part is researching the European market for government bonds. Some leading studies on this topic are Blanco (2001), Pagano and Von Thadden (2008), which tackle the subject of European Monetary Union and its effect on the European debt market. Dunne et al (2006) presents the liquidity and transparency problems of European bond markets, also Dunne et al (2008) researches the aspects regarding the market for government bonds.

The case of Romania is under researched in the case of municipal and government bond market. One reason for that is the recent development of the market which started in 2004 (Alexandru, 2011). Despite the progress made, the bond market in Romania has a small size, a fact specific to Central and Eastern Europe (Bunescu, 2016, Matei et al. 2009b).

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Among the studies that were developed in Romania we recall Matei et al (2009), Grecu (2008), Mosteanu and Lacatus (2008); Lăcătuș & Văduva (2009); Pop & Georgescu (2015); Pop & Georgescu (2016) where different aspect regarding the bond market are presented. Aspects of the Bucharest Stock Exchange (BSE) government bond market where studied by researchers like Danuletiu (2010); Pop et al (2012) and Bunescu (2016).

The development of the bond market in Romania was generated by the financial decentralization of the public sector, a process in which local public authorities received new responsibilities regarding the management of financial resources and the initiation of infrastructure investment projects. In a financial market dominated by bank loans, after May 2001, mayors began to fund themselves through bond issues. Bond issuance proves to be a cheaper source of funding than bank credit, but local authorities have to meet the rigors of the capital market and Bucharest Stock Exchange (BSE), given that the vast majority of municipal bonds are listed on the stock exchange. In despite the many municipal bond issues, their share is rather low, comparable to that held by the corporate bond market dominated by issuers in the banking sector.

A particular impetus for the development of the bond market in Romania is the issue of bonds by international financial institutions such as the International Bank for Reconstruction and Development starting with 2006 The Romanian bond market is dominated by government bonds (which is why the Romanian market resembles the American market of the 60s), and since 2008 these values are listed on the Bucharest Stock Exchange (BSE). This is due to legal regulations as because the 2nd pillar domestic pension funds was launched in July 2008 and their portfolios was supposed to be formed by Treasury securities (Maria Andrada & Cornelia, 2013).

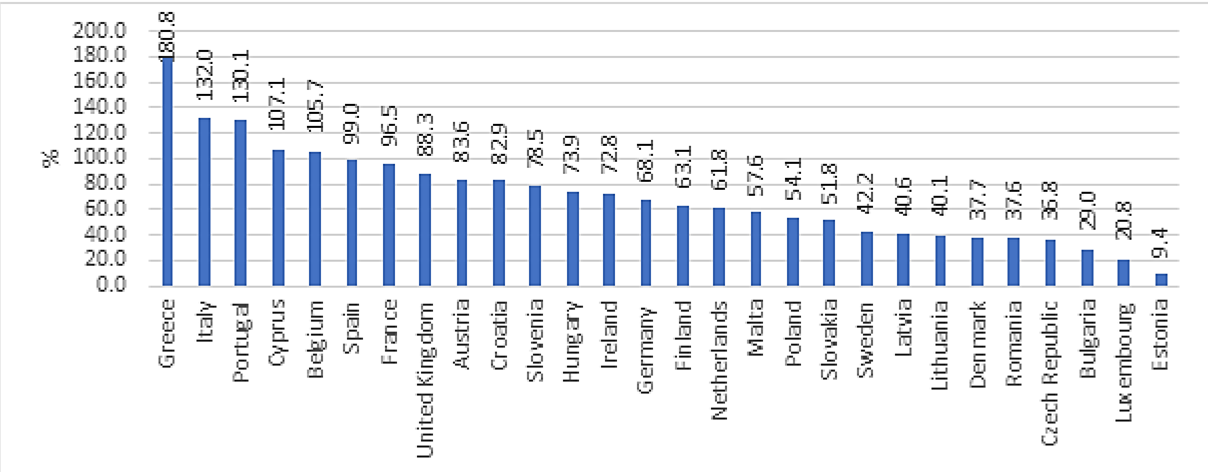
Taking in account all these considerations, in this article, we made an analyzed of treasury securities traded on Bucharest Stock Exchange.

Public Debt in The European Union and Romania

To analyse public debt in EU and Romania, we studied the evolution of the share of public debt related to GDP between the years 2008-2016. We observed that at the level of the EU-28 the public debt registered a growth of 44% from 57.5% in 2008 to 83.2% in 2016, while the Euro area (EU-19) registered a growth of 37% from 64.9% in 2008 to 88.9% in 2016.

All the countries from the EU registered an increase of the public debt share from GDP with one exception, Hungary which has a share of public debt of 57.6% in 2016 while in 2008 the share was of 62.3%. The highest increase of public debt share has been registered by Latvia with an increase of five times from 8% in 2008 to 40% in 2016. Slovenia and Ireland registered an increase of two times the level of 2008. Eight other members registered growths of two times.

Figure1. Public debt as percent of Gross Domestic Product in European Union in 2016



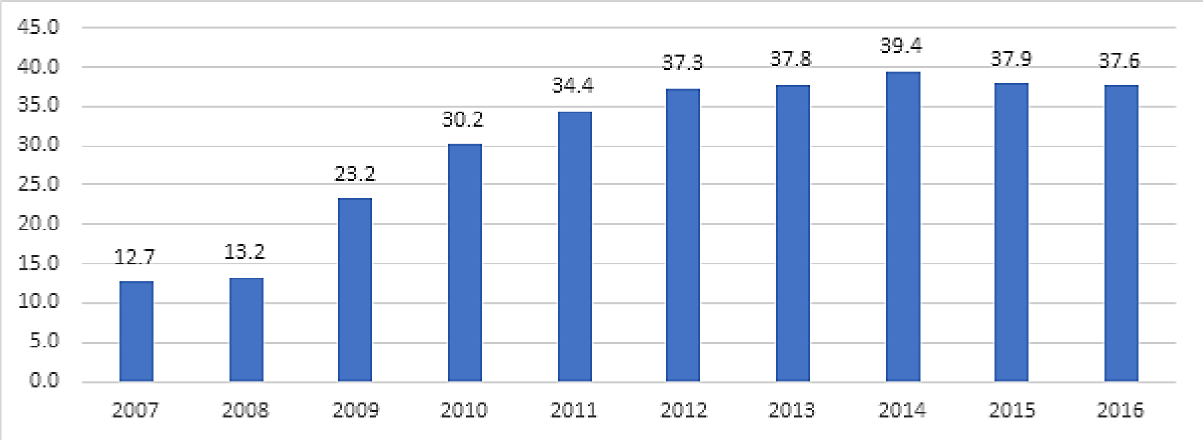
Source: Eurostat

As we can see from Figure 1, at the EU level in 2016, the public debt as percent of GDP ranges from 9.4% in the case Estonia to 180.8% in the case of Greece. Also, we observe that 16 out of 28 European member states registered a public debt higher than 60%, the limit that the Maastricht treaty (1992) imposed for sound fiscal policies along with the 3% annual deficit limit. More than that

5 countries, Greece, Italy, Portugal, Cyprus and Belgium registered a public deficit higher than 100%. This is not a novelty, previous studies (Levisauskaite et al., 2014) mentioning this situation for these countries. More, Romania has a relative low level of public debt, compared with other European Union members (Maria Andrada & Cornelia, 2013; Zaman, 2013).

Romania is the fifth country with the lowest public debt after Estonia, Luxembourg, Bulgaria and Denmark, with a debt of 37.6% of GDP.

Figure 2. Public debt as percent of Gross Domestic Product in Romania in 2008-2016



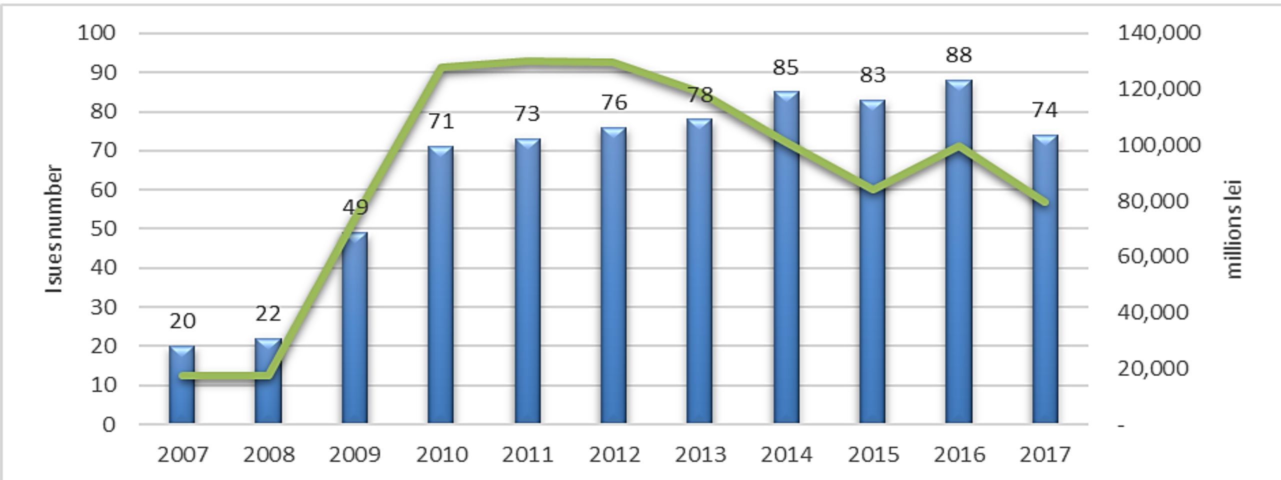
Source: Eurostat

In the case of Romania, we observe in Figure 2 that in the period 2008-2016 it has an ascendant evolution from 12.7% in 2008 to 37.6% in 2016 with a high of 39.4% in 2014. The main reason for the public debt growth was the international financial crisis which caught Romania in a bad financial state, with an overheated economy, fuelled by consumption based on imports.

The Evolution of Romania Government Bond Market and The Bucharest Stock Exchange

The government bond program is one of the main instrument by which the government attracts the necessary funds for its ongoing operations. Romania's government bond program registered an important growth between 2008 and 2010, when the number of issued bonds grew from 22 in 2008 to 71 in 2010. Starting with 2013 we observe that even if the number of government bond issued grew, the total value of those bonds started to decline.

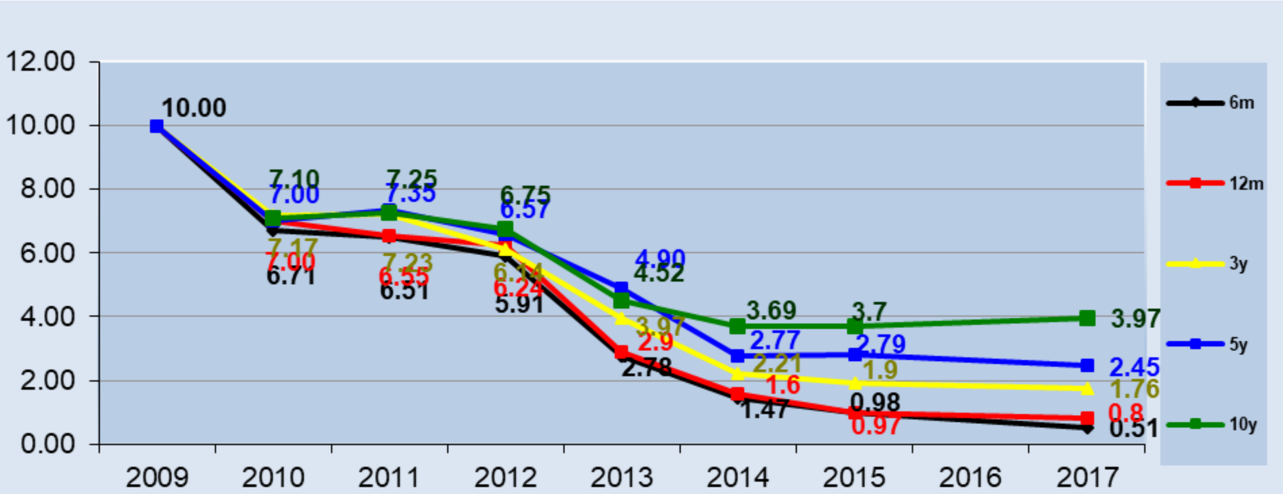
Figure 3. Government bond, treasury certificates issued and value 2007-2017



Source: National Bank of Romania (NBR)

The yields of the government bonds are another important aspect as they have an important effect on the success of the issue. If the interest rate is not high enough there will be no buyers for that bond issue.

Figure 4 The yields evolution on different maturities for Romanian debt



Source: NBR

After the international financial crisis and the speculative attack on the national currency, the interest rates went up. As we can see in Figure 4, according to data from the National Bank of Romania in the last six years the interest rates for governmental bonds registered an important decrease from 10% in 2009 to 3.97% in 2017 for 10 years maturity and to 0.51% for 6 months maturity. Another important aspect is the spread of interest among different maturities from 0% in 2009 to 3.46% in 2017.

Compared to bank deposits, Treasury securities offer higher returns, making it attractive not only to the population but to foreign investors (Matei et al, 2009b; Zaman, 2013).

In 20018, in view of the 100th anniversary of the Great Union, the Ministry of Public Finance launched the Thesaurus Program - the Centenary Edition. Two programs of bonds exclusively for the population (in June and in August) worth 1 leu were held within this program. For the first issue, the interest rate was 5% and matured at five years, while for the second issue the maturity was set at 3 years and the interest rate was 4.5%. The high interest of the population for these titles is due not only to the high interest rates compared to the bank deposits, but also to the fact that the related incomes are non-taxable. By the end of the year, other programs may be launched, possibly with other maturities, up to the annual ceiling of 4 billion lei set for 2018. The main disadvantage of these titles is the long period of blocking of the invested amounts.

According to the issue prospectuses, the securities cannot be redeemed before maturity, they are non-transferable and are not traded. For this reason, the Ministry of Public Finance intends to make the Thesaurus Program more flexible to allow the transfer of ownership over government securities to another investor the natural person and their redemption by the state before maturity.

Conclusions

Even though the market for governmental bonds issues has been in place since 1994 and the secondary market since 1996, it didn't provide the required benchmark for investors until 2007 when a secondary market was in place at the Bucharest Stock Exchange. After the BSE took the role of secondary market the government bond market still didn't reached the required liquidity because the efforts of National Bank of Romania (NBR) and BSE were not sustained by the Ministry of Public Finances (MPF).

The MPF lacks the flexibility and the transparency to provide the support for government bond market to become the benchmark it is required for Romanian market investors.

Lately the MPF started to give to the government bond market the required attention, but there are still a lot of deficiencies to provide a transparent, flexible and liquid government bond market.

The launch of the centenary bills may be another blow to the BSE as these bills can't be traded on the secondary market. The BSE hopes that the next issues may have the permission to be traded on the secondary market, providing so a much-needed liquidity for the potential investor and as a result an increased interest for these bills.

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